

# DG INSIGHTS

## Democratic Governance Insights

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### About DG Insights

DG Insights, an online publication for the Democratic Governance Community of Practice, seeks to highlight emerging trends and substantive issues UNDP/UN practitioners and the larger research community are grappling with and to promote deeper understanding on democracy and democratic governance. We are inviting network members with pertinent experiences and/or thematic expertise on specific topics to contribute to DG Insights at [dgp-net@groups.undp.org](mailto:dgp-net@groups.undp.org)

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## Financial Crisis, Corruption and Challenges for Democratic Governance

### *Corruption, Money and Institutions*

Like the emperor's new clothes, are we ignoring something staring at us in the face? The links between corruption and the current global financial crisis are already spilling from the US into the lives and livelihoods of other economies. This partly, arises from the complexity of defining corruption, especially its presumed association with illegality. A system that rewards risks of collective loss for private gain is intrinsically corrupt. Policies to navigate out of the emerging global recession are also fraught with potential for selectivity and reciprocal deals. We can expect more to come as the downturn itself pressurizes more people into crossing the line – for holding on to their businesses, jobs and homes, for livelihoods. In the past corruption has been recognized as a contributory factor in aggravating the Asian financial crisis of 1997 (Mobarak and Lipscomb 2009). In the US, seeds of systemic breakdown were sown as risk-pricing replaced prudential supervision, fertilized by reward systems that hugely incentivized the promotion of opaque derivative “assets”, and encouraged enormous leveraging by investment banks. Much of this was technically legal. “The financial debacle has many causes and implications, but it would be wrong to underestimate systemic corruption.” (Kaufmann 2009).

*Corruption is not just about bribes.* It is as much a private sector phenomenon as a public one. It thrives in the grey area between government and private players. Exploitation of gaps between private and social good takes place through a collusive misuse of power for furtherance of unintended benefits. Banks, regulators and rating agencies seem to have joined hands in insufficiently acknowledging “shadow” banking and reliance on capital markets - akin to “institutional capture”. Recognizing subtler forms of corruption, forms that may be technically legal (when institutions are “captured” and rules “adjusted” by the powerful), is as important as identifying the more obvious siphoning of resources or dispensing favors. Recall the little child who is unafraid of saying, “...but the emperor has nothing on!” Conceding is a precondition to confronting.

### *Defending Democracies*

All countries face corruption in some form or another. We see headlines about corruption allegations in countries from Japan to the United States, from Indonesia to Fiji. No society has all the answers to this ancient phenomenon.

*Democracies are vulnerable.* Hardly any country has a foolproof solution to electoral funding which induces uncomfortable relationships between businesses and political parties. Widespread corruption may make democracies vulnerable to takeover making it an urgent imperative. Corruption at the top provides ammunition for disgruntled elements and those interested in a share of the spoils to foment unrest. In countries like Bangladesh, Pakistan, Thailand, popular anger against corruption was the stated basis to topple elected governments and impose more authoritarian regimes with adverse consequences for democratic governance.

Publicly siding against corruption can pay enormous political dividends (UNDP 2008). Leadership and people benefit by cooperating to confront it. The poor are hurt the hardest but have little say in shaping institutions or influencing the use of resources. Many forms of corruption cross national boundaries through misuse of channels: via finance, multinational companies, trade, migration, money-laundering or tax-havens.

*Could a focus on corruption sidetrack efforts to improve the living conditions of the poor?* Adequate money and appropriate institutions are needed for progress towards agreed development goals, ensuring that people are at the centre of development discourse, deepening democracies and promoting human development. Corruption undermines both, money and institutions. It does not disappear in the course of development; though forms change. The argument for consciously tackling corruption is the same as that for poverty reduction: countries do not wait for poverty to come down automatically; policies are designed to speed up the process. So also with corruption.

### ***Tragedy of the Commons***

*Good governance is a public good, a common property resource.* Corruption presents a classic case of 'the tragedy of the commons' (Hardin 1968). Hardin recognizes that technical solutions alone cannot solve public good problems. Such problems need behavior change. The dilemma arises because corruption can yield an immediate individual benefit in the short-run, but undermines group interests, eventually leading to institutional breakdown that harms everyone. As more and more people become corrupt, the comparative advantage through corruption can disappear. One may even have to undertake corrupt acts just to stay in place - in an atmosphere of widespread corruption, not doing the same can be costly, thus undermining the integrity of institutions of governance. Increased fraud is being predicted in response to the economic downturn (GAAP web 2009). When an overwhelming majority of the population is corrupt, a minority who is not may make little difference; when an overwhelming majority of the population is not corrupt, a minority who is may make little difference. It is easier not to be corrupt when the non-corrupt behavior is the social norm. Corruption can rapidly undermine institutions, but turning back after that can be very difficult.

In spite of being a part of human behavior, most people would like everyone else to be clean rather than corrupt – as in free rider situations. While group and private interests may diverge in the short run, they are overwhelmingly consistent in the longer-term, providing a strong foundation for public policy backed by institutional arrangements to counter corruption. An example from evolutionary biology provides an interesting parallel to the tragedy of the commons that arises from corruption: the behavior of parasites feeding on a common host. It is in their group interest that the host remains in good physical shape, but solely self-interested behavior destroys the common host, bringing an end to the parasites as well.

### ***Undermining all Development Goals***

*Corruption adversely affects all the Millennium Development Goals and reverses hard earned gains.* While most people are hurt by corruption, the relatively disadvantaged are hurt more as it deepens poverty, debases human rights and creates a sense of injustice and alienation. The poor are less able to bribe and bribe amounts constitute a much higher share of their limited incomes. Moreover, this section of the population has little say in shaping institutions and policies that can be hijacked by big businesses, but that section of the population is impacted by them. It thus limits people's choices in many ways, making it a critical issue for human development (UNDP 2009).

*Corruption in social services hits people's daily lives.* The poor rely much more on public provisioning of health, education and essential utilities like water and electricity, being less able to access private options. Shortages in school seats, drinking water, electricity, teacher vacancies, health facilities, etc., contribute to 'survival' corruption. Corruption in the health sector can compromise drug trials, result in spurious vaccines and other drugs, deprive the poor of health services and even contribute to extreme practices like harvesting organs from the poor without informed consent. It can interfere with access to and quality of education for children and undermine an important institution for building ethics – the education system. Corruption in utilities like water-sanitation and electricity can undermine essential services which are already in short supply and, in turn, adversely affect health.

*Justice is for sale.* The poor are much more affected by institutions of justice like the police and judiciary in everyday lives. Unlike the better off, they cannot hire private security or legal services. They face injustice even when cases are not registered or false ones hoisted due to inability to bribe. They have to pay for justice and to avoid being entangled in injustice. Here again shortages are an important contributory factor. The term "petty corruption" focuses on the money value of bribes, underplaying the large number of people affected and the persistence of the demands. "Retail" corruption better captures the spread. Ironically police and judiciary are part of the anti-corruption machinery.

*Corruption can affect incomes.* People's livelihoods are compromised as income generation programs or credit-access are corrupted. Corruption derails private enterprise by creating disincentives for investment, domestic and foreign. Women can face sexual and other forms of exploitation in accessing and retaining paid work. Corruption drains and diverts scarce resources, squeezes fiscal space, undermines institutions and diminishes a country's prospects for development (UNDP 2008).

*Natural resources provide fertile grounds.* Huge profit potential combined with remote locations and unclear property rights create opportunities for corruption. Collusion between business interests and government can undermine laws and rules regulating the use of forests, land, water or minerals, aggravating environmental degradation, undermining livelihoods and compromising the interest of future generations.

*Circumstances needing financial and material aid are vulnerable.* Government and international responses to (a) conflicts or natural disasters and (b) longer-term deprivation of the poor, the remotely located or socially excluded, involve inflow of large sums of low-cost or no-cost funds. These sums have to be spent quickly. Moreover in emergencies, standard operating procedures may not apply as in pressing humanitarian situations or in the present global financial-turned-human-crisis. Private and public actors can find such situations tempting when a fast buck can be made. The beneficiaries may accept less than their due because of their vulnerability, lack of information on eligibilities, and a willingness to accept something as better than nothing. However, the effects of diversion of funds are very serious – a breakdown of trust between the governing elite and the governed, dissension among communities, political instability, and aggravation rather than mitigation of disaster impacts. Clear links between corruption and special development situations have been established (Evans 2007).

Even well meaning policy responses to the economic downturn are at-risk-to-corruption. There is discussion in the media about US “earmarks” committing federal funding. Daniel Kauffman (2009) points out:

**“First, the public sector is reshaping regulation; second, the government is becoming an owner of financial institutions; third, it is bailing out selected private concerns through a quick and massive infusion of funds; fourth, it is to provide almost a huge fiscal stimulus into infrastructure; and fifth, it intends to extend the social (and housing) safety net for millions of vulnerable citizens.**

There are governance and corruption risks in each of these areas. Lobbyists are already at the door...”

### **Combating Corruption**

*Corruption is being increasingly pushed to the front across countries.* Governments are not just acceding or ratifying the UN Convention Against Corruption, they are also recognizing the mood of the people, the role of private actors (including banks, lawyers and accountants), and the importance of cross-border cooperation. As people become less willing to tolerate corruption and disruptive elements demonstrate readiness to destabilize governments, combating corruption makes good political, strategic and moral sense – much more than ever before. There are practical, strategic and moral reasons to challenge the scourge. Practically, developing countries need resources, internal and external. Corruption can undermine resource availability, squeeze fiscal space and divert scarce funds to non-development priorities. For political leadership, being seen on the side of curbing the scourge, more so where it affects daily lives of people, like in social services for example, can make good political sense. It contributes to enormous citizen satisfaction. Strategically, we need citizens to cooperate in the social contract with governments and the private sector. Where the legitimacy of the institutions of power and privilege are questioned unrest may follow. Morally, corruption constitutes a disrespect for fellow human beings, for equality. It disproportionately harms the poor. We need to counter it for all these reasons.

While specific measures will be shaped by local circumstances, an overall strategy should combine the synergy between simultaneous pressure from above and below – each keeping the other ‘honest’. Pressure from top involves strengthened anti-corruption agencies, right to information legislation and civil service reform; bottom-up strength derives from a free and competitive media and a vibrant and informed civil society that uses information and expects deepening of transparency. Greater reliance on prevention rather than ‘catch-and-punish’ after the fact should be encouraged. This involves effective disclosure, credible audits, verifiable norms and standards for all institutions. And a large part of ‘survival’ corruption needs supply responses to deal with shortages rather than punishing the poor for stealing water or electricity. [“Tackling Corruption Transforming Lives”](#) identifies a seven point agenda for change (UNDP 2008).

*\* This paper draws on the work of the Human Development Report Unit located at the Regional Center for Asia-Pacific, Colombo Office, undertaken for the Asia-Pacific Human Development Report, “Tackling Corruption, Transforming Lives”.*

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